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Supreme Court of the United States

OCTOBER TERM 1961

No. 72

STATE OF WISCONSIN and PUBLIC SERVICE COMMISSION OF WISCONSIN, and

PUBLIC SERVICE COMMISSION OF THE STATE OF NEW YORK,
Petitioners,

v.

FEDERAL POWER COMMISSION,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT.

MEMORANDUM IN REPLY TO RESPONDENT'S BRIEFS IN OPPOSITION.

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IN THE

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OCTOBER TERM 1961.

No. 754.

STATE OF WISCONSIN and PUBLIC SERVICE COMMISSION OF WISCONSIN, and
PUBLIC SERVICE COMMISSION OF THE STATE OF NEW YORK,
Petitioners,

v.

FEDERAL POWER COMMISSION and
PHILLIPS PETROLEUM COMPANY,
Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT.

MEMORANDUM IN REPLY TO RESPONDENTS' BRIEFS IN OPPOSITION.

In our petition seeking a writ of certiorari, we urged that this Court should grant review because of the importance of the case and its enormous impact on the ultimate consumer. The case was important, we asserted, because the court below had endorsed a Federal Power Commission determination to *abandon* the admittedly lawful cost method of regulation (which, at the point of its abandonment, had not yet been tried for producers, but was then ready for application) in order to pursue an area-price method, which would not become effective for from four to fourteen years. It was our contention that until the area price method

becomes effective, the Commission should take advantage of its own and other parties' enormous investment in the traditional individual-company-cost method of regulation to fix the rates of those major producers which, like Phillips, had already gone through hearing proceedings and briefing. It was our further contention that, during the four- to fourteen-year period while proper area prices were being evolved and determined, adequate consumer protection would not be provided by the Commission's promise to use its newly-announced interim area price levels to "test" the propriety of increased rates for old sales and initial prices for new sales.

The Federal Power Commission's Brief in Opposition in no way controverts our allegation that the issue involved is of crucial importance in the administration of the Natural Gas Act. Neither does it expressly controvert our allegation that the decision below will have an enormous impact on the consumer. Rather the brief makes three major points:[1]

1. That the Commission determination not to require refunds of the rate increases collected between 1955 and 1959 was proper. (FPC Brief, pp. 11-12.)

2. That during the long period until area pricing becomes effective, use of the rate levels set forth in the Commission's Statement of General Policy (the SGP levels) will "hold the line" and thereby protect the consumer. (FPC Brief, pp. 13-18 middle, 19 middle-20.)

3. That, in any event, the vast bulk of Phillips' rates, and by implication the rates of most other producers, are

[1] A fourth point (FPC Brief, pp. 20-23), directed solely to an argument raised by California, a petitioner in No. 756, is not considered in this memorandum.

subject to refund which could be ordered at the outcome of the area rate proceedings. (FPC Brief, pp. 18-19.)

None of these arguments warrants the Commission's request that certiorari be denied; all three are rather arguments suggesting affirmance of the decision below once certiorari is granted. We shall, nonetheless, direct ourselves to each of these arguments.

1. Contention That Allowance Of Rate Increases Was Proper

As part of its opinion in this case, the Commission allowed in full ten of the twelve Section 4 rate increases which had been consolidated with the Section 5 future-rate investigation. Pursuant to these increased rate filings, Phillips collected additional revenues of approximately $5.3 million annually in 1957-1959, and lesser amounts in 1955-1956. The stated basis for the Commission's action was the finding that in 1954 Phillips' jurisdictional costs were $54.5 million and its jurisdictional revenues $45.6 million. However, the Commission itself took the position that the 1954 test year was too stale to provide a basis for fixing future (i. e., 1960 and thereafter) rates in the Section 5 docket. By the same reasoning, of course, the 1954 test year would be too stale to evaluate the propriety of rate increases in effect between 1955 and 1959.

Furthermore, there is an even more compelling reason why the $8.9 million jurisdictional deficit in 1954 was an inadequate support for the allowance of the $5.3 million increase for the latter years. Throughout this entire period the Commission had authorized Phillips to initiate new sales at progressively higher and higher prices, a factor which could be expected to eliminate, or at least mitigate sharply, the $8.9 million deficit which obtained in 1954.

These new sales generated substantial additional revenues, which were given no consideration by the Commission when it allowed the instant rate increases to become final. See *Smith* v. *Illinois Bell Telephone Co.*, 282 U. S. 133 at 161-2 (1930).

2. Contention That SGP Levels Provide Adequate Protection

The Commission rather frankly recognizes (Brief, p. 15) that the refusal to regulate producer rates on an individual-company-cost basis pending the outcome of area rate hearings will result in a "hiatus in regulation" unless there is adequate interim control exercised during the long period necessary to bring the area rate proceedings to conclusion.

Before turning to the adequacy of the interim method chosen by the Commission, we wish to discuss the inordinate length of time which will be required to bring the area rate proceedings to that ultimate conclusion, and in this regard it is necessary to correct a perhaps inadvertent impression of progress created by the FPC's statement (p. 14) "that there are now in progress proceedings to fix [area rates] in two of the country's major producing areas, which are also two of Phillips' largest producing areas." We assume that the Commission here is referring to the area rate proceedings for the Permian Basin and for Southern Louisiana. As to the Permian Basin, which accounts for less than one-eighth of all gas sold in interstate commerce, hearings are indeed presently in progress, but they have thus far been confined to non-cost, non-financial-requirement types of evidence, notwithstanding the Commission's representation here (Brief, pp. 13-14) that the area prices will be based "on the reasonable financial requirements of the industry" and on "the use of typical

or composite cost data." Thus, the evidence which the Commission here asserts will be primarily relied on in fixing area rates has not yet even been presented by any party to the Permian Basin proceeding; the most that can be said of the proceeding is that, more than a year after its institution, it is still in a hopelessly early stage, with the key evidence not yet presented. The second proceeding, relating to area rates for Southern Louisiana, is even less advanced. Though instituted a year ago, it has proceeded no farther than inconclusive prehearing conferences, which are now in indefinite recess, and no formal hearing has been held, nor is any set. It is evident, therefore, that the estimate of the court below that another four to fourteen years would be required to bring the area rate proceedings to conclusion was, if anything, unduly optimistic.

We turn now to a consideration of the degree of consumer protection which will be afforded during the interim by the SGP levels, announced by administrative fiat contemporaneously with the Commission's Phillips Opinion. As we noted in our original petition, the policy statement sets forth for each producing area two levels—one, the "old gas" level, to be used as a guide to the Commission in determining whether to *suspend* Section 4 rate increases for old gas, and the other, the "new gas" level, to be used as a basis for imposing price conditions in certificating sales of new gas in interstate commerce. In our petition we alleged that the old gas level in each area was in essence the 1959 weighted average wellhead price for the area, and that the new gas level represented each area's highest previously certificated price at the time the policy statement was announced in September 1960 (see Petition, Appendix D). Though the Commission apparently disputes this analysis (FPC Brief, p. 17, n. 12), its denial is unsupported and hence unconvincing. It seems obvious, therefore, that

the "line" which the Commission proposes to hold by use of the SGP levels is the 1959-60 line—the product of *six years* of ineffectual regulation. In his recent and important report on the federal regulatory agencies, Dean Landis stated that the Commission's action in promulgating area rates,

> ". . . whether ultimately legal or not, has come far too late to protect the consumer. The area prices there set forth substantially reject the rate base approach and the fixed area prices come close to approximately current maximum prices, which have more than doubled in the past five years. The Commission's past inaction and past disregard of the consumer interest has led the states to seek to force it to discharge its responsibilities. It is somewhat of a phenomenon in our national life for the state utility commissions to be ranged against a federal commission in an effort to protect consumers against monopolistic and excessive rates."[2]

In an attempt to explain away a conflict between the decision below and the long line of decisions by the same and other circuits,[4] the Federal Power Commission draws a distinction, as novel as it is meaningless, between "current prices" and the lower "policy prices" that are to be used in determining whether to suspend rate increases

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[2] Landis, *Report on Regulatory Agencies to the President-Elect*, pp. 55-56 (1960).

[3] *City of Detroit* v. *F. P. C.*, 230 F. 2d 810 (1955), cert. denied, 352 U. S. 829; *Mississippi River Fuel Corp.* v. *F. P. C.*, 252 F. 2d 619 (1957), cert. denied, 355 U. S. 904; *Episcopal Theological Seminary* v. *F. P. C.*, 269 F. 2d 228 (1959), cert. denied, 361 U. S. 895; *Willmut Gas & Oil* v. *F. P. C.*, 299 F. 2d 111 (1962).

[4] *Bel Oil Co.* v. *F. P. C.*, 255 F. 2d 548 (5th Cir. 1958), cert. denied, 358 U. S. 804; *Forest Oil Co.* v. *F. P. C.*, 263 F. 2d 622 (5th Cir. 1959); *United Gas Improvement Co.* v. *F. P. C.*, 290 F. 2d 133 (5th Cir. 1961), cert. denied, 368 U. S. 823.

(Brief, pp. 19-20). Recognizing that use of "fair field prices" has been judicially discredited,[5] the Commission asserts that the "policy prices" are not "fair field prices" because they are "far below current prices". To the extent that the Commission is giving the phrase "current prices" its usual meaning—i.e., the weighted average price currently being paid for all gas in interstate commerce—the Commission's statement is incorrect. In 1959, the last year for which figures were available at the time the Commission adopted its area price levels, the weighted average price of gas sold in interstate commerce was 14.3¢ per Mcf, or almost exactly the level that would be arrived at using the Commission's "old gas" price levels, which range from a minimum of 11¢ to an apparent maximum, for the major producing states, of 15.75¢ per Mcf.[6] If, on the other hand, the Commission means by "current prices" not the prices being paid *on the average* for gas currently being *sold* in interstate commerce but the prices currently being negotiated or paid for *new* dedications of gas to the interstate market, its argument fares no better. At the time "fair field price" was first espoused by the Commission as a method of regulation[7] it represented not the "current price", in this esoteric sense, but rather the weighted average price for all gas being sold, which is *precisely* the same standard now used by the Commission in arriving at a "policy price" to determine whether to suspend rate increases.

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[5] See cases cited in previous two footnotes.

[6] The 15.75¢ price, adopted for Louisiana, includes, as does the 14.3¢ weighted average referred to earlier, an allowance for "tax reimbursement".

[7] *Panhandle Eastern Pipeline Company*, 13 FPC 53 (1954), rev'd sub nom. *City of Detroit* v. *F. P. C.*, 230 F. 2d 810 (D. C. Cir. 1955).

3. Contention That Bulk of Phillips' Rates Are Subject To Refund

As an integral part of the argument that its interim method of regulation—i.e., use of SGP levels pending outcome of the area proceedings—provides adequate consumer protection, the Federal Power Commission asserts (Brief, pp. 18-19) that over 80% of Phillips' 1960 jurisdictional revenues were collected subject to refund. The legal basis for this claim is nowhere stated—we suspect that it would be sharply challenged by Phillips, the Commission's co-respondent here—and we assume that it stems from the contention that when a natural gas company files a rate increase, the *entire* new rate, and not merely the amount of the *increase,* is subject to refund. To illustrate: assume a company files an increase under Section 4 from an existing level of 20¢ per Mcf to an increased level of 21¢ per Mcf, and the Federal Power Commission permits the increase to become effective subject to refund; after three years of collection at the higher rate, a hearing is held on the justness and reasonableness of the increased rate, and the Commission finds that the just and reasonable rate is 12¢; may it order refunds of the increased amount only (the 1¢) collected during the three years, or may it direct refunds of 9¢ for each Mcf sold during the entire three-year period?

We understand it to be the Commission's contention, asserted in its brief here, that it could order refunds of the entire amount, and it is on this basis that the 80% refund figure has been computed. The Commission is, of course, entitled to make such a contention. We are surprised, however, that it failed to advise this Court that the matter is an open one and that in 24 years of regulation under the Natural Gas Act the Commission apparently

has never directed refunds greater than the amount of the increase. In fact, the question was last presented to the Commission just a year ago, at which time the Commission stated: "It has apparently never been settled whether a refund can be ordered that reflects a rate decrease below settled rates previously in effect. We do not believe we have to decide that question here. . . ." *Panhandle Eastern Pipeline Company*, G-2506, FPC Opinion 344, 25 FPC 787 at 803 (1961).

Furthermore, in showing amounts collected subject to refund, both the industry (for income statement and balance sheet purposes) and the Commission have consistently shown only the amount of the *increase*, not the entire rate as increased. Thus, for example, the Annual Report (Form 301) filed with the FPC by Phillips for 1960—from which the Commission claims to have "computed" (Brief, p. 18, n. 15) that $74 million of Phillips 1960 revenues of $90 million are subject to refund—shows under the column "revenue subject to refund" a figure of only $20 million; and the report bears no notation that the figure is challenged by the FPC or its staff. Phillips' practice of showing as subject to refund only the amount of the increase is consistent with the practice followed by every other producer and pipeline in filing the Commission-required Annual Reports. Moreover, in its own statistical tabulations, in its reports to Congress, and in its prior representations to this Court, the Commission has always shown as subject to refund only the amount of the increase. F. P. C. Release 9602 (December 27, 1957); *Tabulation of Gas Rate Increases* (prepared by FPC at request of House Subcommittee on Legislative Oversight, April 15, 1960), pp. 8-9; Petition of FPC for Writ of Certiorari, pp. 27-28, esp. note 27, *F. P. C. v. Memphis Light, Gas and Water Division*, No. 694, October Term 1957.

But, even if the bulk of Phillips' rates were *assumed* to be subject to refund, this would be irrelevant, for as the Commission has itself recognized and as it has recently told this Court, consumers are not adequately protected while "they continue to pay excessive rates, by the [natural gas company's] ultimate obligation to refund the excess charges with interest". Petition of FPC for Writ of Certiorari, p. 10, *FPC* v. *Tennessee Gas Transmission Co.*, this term No. 591, cert. granted, 368 U. S. 974 (1962).[8]

And finally, upon the same assumption, is it not a sad commentary that 80% of the revenues of a major gas producer should be collected subject to refund and that such revenues should continue to be so tainted for another decade or so, while the Commission ignores the "just and reasonable" (to company and consumer) standard of the Natural Gas Act? Of what realism is the ostensible assurance of refund a decade or so hence, by even the strongest financial giant, of 80% of its total receipts for a past period of that magnitude?

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The FPC asserts (Brief, pp. 10-11):[9]

> "No one can seriously deny that a regulatory agency has 'broad discretion in selecting an appropriate means or method of regulation.'"

As regulatory agencies themselves, petitioners agree with the point being made, but hasten to add that it is hardly dispositive of this case. Agency discretion must be exercised in a manner not inconsistent with the legislative purpose, *Atlantic Refining Co.* v. *Public Service Commission*,

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[8] Indeed, the whole basis for the interim order provision which the Commission so earnestly seeks to protect in the *Tennessee Gas* case is the Commission's recognition that refund provisions do not provide adequate protection to consumers.

[9] To similar effect, see Phillips Brief, pp. 18-19.

360 U. S. 378 (1959), and there is no theory of agency discretion which permits the Federal Power Commission to ignore for any period of time the mandate of Congress and of this Court to fix just and reasonable rates for Phillips Petroleum Company.[10]

For the reasons stated in the petition and in this memorandum we respectfully submit that the petition for a writ of certiorari should be granted.

Dated May 3, 1962.

Respectfully submitted,

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[10] In his *Report on Regulatory Agencies to the President-Elect* (1960), Dean Landis refers to "the unwillingness of the [Federal Power] Commission to assume its responsibilities under the Natural Gas Act and its attitude, substantially contemptuous, of refusing to obey the mandates of the Supreme Court of the United States. . . ." (p. 55)